COMMONWEALTH OF MASSACHUSETTS
before the
DEPARTMENT OF PUBLIC UTILITIES

Massachusetts Electric Company	)	**D.P.U. 96-25**

REPLY COMMENTS OF THE ATTORNEY GENERAL

Respectfully submitted,

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I. Introduction

Pursuant to the procedural schedule adopted by the Department, the Attorney General hereby replies to the comments filed on October 29 in which various parties articulated positions relative to the terms of the Settlement Agreement filed with the Department by divers parties on October 1, 1996 (hereinafter, "the AG/NEES Agreement" and/or "the Agreement"). These comments are necessarily brief. Given the short response time, the immediate pendency of a pre-hearing conference as well as three days of evidentiary hearings to be followed by responsive briefing, the Attorney General is constrained in these comments to attempt little more than assisting the Department in identifying, not necessarily resolving, the larger issues presented in the October 29 submissions.

The Attorney General has read and considered carefully all of the written comments submitted as well as the comments received at the public hearings during the past five weeks, but he has not attempted here to respond to every one of those comments. His silence here should not be construed, interpreted or otherwise understood to constitute or be indicative of any acquiescence to or agreement with those comments. After full consideration of the comments, the Attorney General submits that the Department should approve the AG/NEES Agreement as it will produce just and reasonable rates that are not only in the public interest but also rates that,

more likely than not, will be lower than the rates that would be in place in the event that the Agreement were not approved.

The various parties' comments are addressed in the following order. First, the Attorney General states his understanding of the major comments that concern aspects of the AG/NEES Agreement that bear directly on the question of whether the Department should approve the Settlement, *i.e.,* matters affecting the level and design of future prices to be charged by MassElectric,[1] the rights/obligations of customers relative to past agreements with MassElectric, and the extent of distribution service unbundling required/permitted under the Agreement. This is followed by a brief statement of the issues raised in comments that concern matters addressed within the Agreement document but which need not be resolved as a condition of the Agreement, *i.e.*, future terms and conditions for MassElectric distribution customers (Attachment 4), for power suppliers serving MassElectric distribution customers (Attachment 9), and for MassElectric and AllEnergy employees (Attachment 14) as well as various wholesale market questions yet to be resolved by the FERC and outside the scope of this agreement (the jurisdictional allocation between transmission and distribution, the particulars of any NEPOOL reform, as well as the future structure of transmission service transactions incidental to sales of power within a particular transmission owning entity's service territory). No comments are provided at this time in response to comments raising issues concerning matters not covered by the agreement, *e.g.*, standards to be applied to future mergers. The Attorney General reserves his right to respond in the briefs to be filed later, to any comment made to date or to be made, including but not limited to comments concerning the issues to be addressed or deferred in the pending decision in DPU 96-100.

[1] It is important to note that included within these matters, but not addressed specifically herein are the elements of the standard offer that Enron Capital & Trade Resources suggests are not "central to the Settlement..." Comments of Enron Capital & Trade Resources (hereinafter "Enron"), pp. 3, 6-7.

II. Issues That Bear On Department Approval Of The Settlement

. Matters Concerning Level Of Future MassElectric Rates

1. Recovery Of Stranded Costs

a. Comments

The comments opposing or expressing concern regarding the terms of the Agreement that address MassElectric's recovery of amounts to offset the potentially strandable generation related costs of its affiliate, New England Power Company, focus on four aspects of the Agreement:

(1) the appropriateness of allowing any recovery of strandable costs, *see* Comments of MASSPIRG *et al.*, pp. 1 and 2; Comments of Local 464 *et al.*, pp.7-8, 18-19;

(2) the amount of New England Power Company's costs to be treated as strandable, *see* Comments of Alternative Power Source, pp. 2-3; Comments of Federated Department Stores, pp. 4-6; Comments of MASSPIRG *et al.*, p. 2;

(3) the initial and ongoing estimates of the amount by which power purchased under long term contracts with non-utility generators is priced above market prices, *see* Comments of Federated Department Stores, p. 6; Comments of Alternate Power Source, p. 1; and

(4) the mechanics by which New England Power Company will implement the required divestiture of its fossil and hydro generation assets as well as credit the net proceeds against its contract termination charges. *See* Comments of WMECo Industrial Customer Group, pp. 2, 4-6; Comments of Massachusetts Alliance of Utility Unions, pp. 6-8; Comments of Alternative Power Source, p. 3; Comments of Federated Department Stores, p. 4, n. 1.

. Response

Notwithstanding his long standing position that electric utility shareholders should bear the burden of any past costs that may be stranded as a result of electric utility restructuring, the Attorney General submits that, when considered in the context of the overall Agreement, the

terms of the Agreement concerning the strandable costs of New England Power Company are reasonable and should be approved by the Department. The essence of the Agreement's terms on strandable costs is simple: in exchange for the creation of an access charge designed to provide recovery of amounts to offset NEP's net, non-mitigable strandable generation costs, MassElectric has, among other things, agreed to reduce by nearly twenty percent the current rate impact of these costs, to divest itself of all of its non-nuclear generating assets as well as all of it other non-transmission assets (irrespective of whether they have at some time been included in rate base) and to make available a competitively procured "standard offer" that will result in further, certain savings from current rates.

Not only does the required divestiture of NEP's non-nuclear assets ensure that any "strandable cost" recovery be limited to amounts actually stranded, but it also holds a very real potential for savings beyond the minimum of ten percent called for under the terms of the Agreement. It also provides a meaningful step towards ensuring the development of a vibrant competitive market for power.

These terms will result in customer bills that are significantly lower than they are today or are likely to be in the future in the absence of a successful restructuring settlement. These terms produce rates that are "just and reasonable" and advance the public interest. As is discussed below, nothing in any of the comments supports a different conclusion.

First, the Department cannot object to the Agreement solely because it allows MassElectric to impose a charge designed to recover NEP's strandable costs. The Department and the FERC have been express in their stated intentions to allow such recoveries. *See* proposed 220 C.M.R. §§ 11.00 *et seq.* and 18 C.F.R. § 35.26 - Recovery of stranded costs by public utilities and transmitting utilities. Because the Agreement calls for rates of return on the unamortized balance of any such costs that are — in the absence of substantial mitigation of such costs — well below those now allowed in current system, it provides for lower strandable cost charges than those that would be imposed by regulators in the absence of a settlement.

Second, notwithstanding arguments by some parties that the Department should reject the terms of the Agreement calling for strandable cost recovery of the full net book value of NEP generation assets — either to reflect estimates of the likely market value of the assets, *see* Comments of Federated Department Stores, pp. 4-5; Comments of Alternate Power Source, pp. 2-3, or to eliminate costs associated with "bad decisions" made in the past, *see* Comments of MASSPIRG, *et al.*, p. 2 — the Attorney General submits that, considered in the context of the entire Agreement, these terms are reasonable and, unlike any other methodology that relies on an approach other than market value to supply the appropriate amount, will produce real and timely savings for consumers. The Attorney General submits that the strandable cost valuation methodology incorporated in the Agreement will, in the shortest time possible, produce significant price reductions for consumers. Not only will this approach avoid protracted and potentially fruitless litigation, but the Department should find that it will provide the greatest benefit to the public interest.

Third, there is absolutely no merit to the suggestion that the Department should reject the Agreement because of the market price estimates that were used in determining the initial determination of the strandable cost component attributable to uneconomic long-term, non-utility generator contracts or because this component of the access charge is not reconciled until after the year 2000. There is substantial support for the market price estimate employed by MassElectric. Moreover, a temporary delay in any reconciliation that may be required is not objectionable, and indeed, will tend to dampen the potential disruptive variability in the access charge over the early development of a mature, stable market.

Fourth and finally, it should be plain that the provisions of the Agreement concerning the mechanics of the required divestiture and the resulting credits against the access charge, are not only clear but also produce reasonable rates. The specific form by which divestiture will be accomplished is to be set forth in a plan to be filed with and approved by the Department. Thus, there is no basis for any concern over the existence of adequate protections to ensure that the

proceeds are maximized. Moreover, because NEP has a significant financial incentive based upon the average level of its access charge, *see* Agreement, Vol. 2, p. 55, the Agreement already creates incentives for the incentive to occur in a timely manner.

2. Competitive Implications Of Standard Offer Pricing

. Comments

Some commenters have asserted that the pricing of the standard offer will have an adverse impact on competitors.[2] As support for this rather dubious objection to the Agreement, these commenters rely upon the fact that the price of the standard offer in the first four years is less than that contained in a forecast of wholesale power prices that was prepared recently by Northeast Utilities and submitted to the New Hampshire Public Service Commission. *See* Comments of Alternate Power Source, pp. 3-4; Comments of Wheeled Electric Power, pp. 5-9; Motion To Intervene of Freedom Energy Company, L.L.C.; *see also* Comments of The Flatley Company, p. 2 ("The standard offer *may* be impossible to compete with ...")(emphasis supplied). *But see* Comments of IRATE, p. 2; Comments of Local 464, *et al*., pp. 12-13, 16-18 (suggesting standard offer prices and certainly the increases in those prices are too high).

. Response

The Attorney General submits that the Department can and should conclude that the pricing of the standard offer that is required is reasonable and is not unreasonably anti-competitive. While it is true that the pricing required in the very early years of the standard offer may not itself be high enough to support the construction of new power plants,[3] that is not a bad result from a public policy perspective in an environment universally understood to be characterized by significant excess capacity. Competition, in general, and restructuring, in

[2] The Comments of Local 464 *et al*, address the pricing of the standard offer, *see*, p. 28, but it is not clear whether the objection set forth in that passage is that the standard offer pricing is too low or too high.

[3] Materials to be submitted to the Department as part of the Massachusetts Electric Company's response to DPU Information Request 1-7 indicate that the standard offer will exceed the "all in" cost of retail power from a new plant in the year 2001.

particular, is not about making it any easier to built power plants that are not needed. Rather, they are about reducing costs to consumers by eliminating uneconomic costs, *i.e.,* waste and fat such as excess capacity beyond that for which consumers are willing to pay. The prices in the standard offer are well above those observed in both the New Hampshire and the Massachusetts Electric Company pilot programs. Moreover, there is no doubt or assertion by anyone that these price are above the expected marginal cost of production. Thus, it should be obvious that although the standard offer prices may make it difficult for vendors to make as much money as easily as they desire, those prices are not in any cognizable sense "anti-competitive." Because restructuring is intended to put consumers, not vendors first, the Attorney General submits that Department should reject the objections concerning the pricing of standard offer service.

. The Ten Percent Price Reduction

. Comments

Some commenters have either objected to or expressed concern over the terms of the Agreement that provide exceptions to the requirement that MassElectric maintain, on an inflation adjusted basis, the value of the ten percent cut in rates that is required to go into effect on the first day that retail access is permitted. In particular, these commenters have argued that the Department should reject those terms of the Agreement that provide exceptions for significant tax and accounting rule changes, significant fuel price increases beginning in 2000, and distribution rate increases that may be necessary in the years 1998 through 2000 to increase its allowed rate of return to six percent. *See* Comments of Alternative Power Source, p. 4; Comments of MASSPIRG *et al.*, p. 2; Local 464, *et al*., p. 27

. Response

The Attorney General submits that there is no merit to commenter concerns about the durability and effectiveness of the term governing the real value of a ten percent price cut from current rates. When considered in the context of the NEP divestiture requirement, the real value of the ten percent price reduction called for under the terms of the Agreement is, for all practical

purposes, certain through the year 2004. Moreover, even if one assumes that the NEP assets produce no net monies and there are future fuel price, tax law or accounting rule changes beyond current contemplation, the agreement will produce bills for standard offer consumers that will be at least ten percent lower than those that would prevail under the current system, a system in which fuel and tax changes are passed on routinely and in which the Department consistently has found that the cost of equity capital for electric utilities is well in excess of ten percent. The Attorney General submits that the price reductions required under the Agreement are far greater than any that are likely to occur during this century as a result of litigation and that, because they are significantly less than those that are now and would in the future be in place under the current system, the Department should find that the resulting rates are just and reasonable.

4. The 1998 $45 Million Distribution Rate Increase

. Comments

One commenter expressed concern over the terms of the Agreement that allow MassElectric's distribution rates to increase by $45 million on the date that retail competition is made available to its customers. Notwithstanding the fact that even after this modest increase in its distribution rates MassElectric will be have the lowest distribution rates of any investor owned utility in the Commonwealth, the commenter questioned the need/basis for the increase. *See* Comments of IRATE, p. 2.

. Response

The Attorney General submits that the Department can and should find the $45 million increase in the distribution rates of MassElectric called for in 1998 under the terms of the Agreement will produce just and reasonable rates. This amount of this increase is consistent with the $30 million increase allowed by the Department in 1995 and would be followed by a rate freeze through the end of the year 2000. Moreover, it is supported by a full cost of service filing contained in the settlement documents. Finally, notwithstanding this increase in the Company's distribution rates and assuming that the divestiture of NEP assets does not result in

any reduction in the access charge (a wholly unreasonable assumption), even with nominal three percent annual increases in distribution rates after the price freeze, the settlement agreement will yield total **nominal** MassElectric per kWh prices of "wires service," including access charges, that, at a minimum, will fall from 6.1¢ in 1998 to 5.9¢ in the year 2003.

. Matters Concerning The Extent Of Unbundling Of Distribution Services

1. Comments

The comments opposing or expressing concern regarding the terms of the Agreement that address the required/permitted unbundling of MassElectric's distribution service focus on two broad elements of distribution service:

(1) metering, including the installation, maintenance, reading, and ownership of meters, *see* Comments of Enron, p. 2, 5-6, 11-12; Comments of Western Massachusetts Industrial Group, pp. 5-6 and Comments of DOER, pp. 13, 17-18;

(2) billing and collection, *see* Comments of Enron, pp. 2, 5-6, 12-14; Comments of Western Massachusetts Industrial Group, pp. 5-6 and Comments of DOER, pp. 16-17.

2. Response

Notwithstanding the fact that additional savings may be available to some customers if some existing distribution service elements were unbundled, the Attorney General submits that Agreement strikes the appropriate pace and balance for additional unbundling and urges the Department to approve these aspects of the Agreement as written. There are many unanswered issues concerning distribution unbundling that should be addressed in an orderly manner after the larger issues relating to retail access have been resolved and choice is in fact available, *e.g.*, redlining and cream skimming. Suppliers may be more than willing to read meters in industrial parks and in the suburbs and unwilling to read meters in the less affluent or rural areas. Meter reading must not be geographical in nature. Moreover, there is not any obvious effective solution to the "supplier of last resort" in regards to meter reading and billing and collection services. In these circumstances it is not clear whether unbundling would necessarily be in the public interest

just because it can be done. The resulting costs to remaining service customers of MassElectric may be unconscionable.

III. Issues That Do Not Bear On Department Approval Of The Settlement

A. Payment Of Monies For Employee/Municipal Transitions

. Comments

Comments, both in written form from unions representing NEES employees and in testimonial form by local officials, have been received objecting to the Agreement's terms providing for the recoverability of labor costs and payments in lieu of taxes incurred to address the impact of restructuring on employees and local governments. *See* Comments of Massachusetts Alliance of Utility Unions; Comments of Local 464, *et al.* These essence of these comments is that the Agreement does not provide a complete solution to labor and municipal finance issues raised by restructuring.

. Response

While the Attorney General is aware of and committed to working to assist the relevant parties in reaching reasonable and mutually agreeable solutions to the labor and municipal finance issues resulting from restructuring, he submits that the solution to those problems is outside of the Department's jurisdiction.[4] Indeed, it is not possible to provide a compete solution in the context of a restructuring agreement. Moreover, some portions of the solution — addressing the manufacturers exemption from the payment of taxes on equipment — are within the exclusive jurisdiction of the legislature.

B. Matters Concerning MassElectric Terms And Conditions

1. Terms And Conditions For Power Suppliers

a. Comments

[4] Contrary to the implication of the passage that appears on page 21 of the Comments of Local 464, *et al*., the Attorney General has and will continue to extend every effort to ensure that reasonable transitional terms are made available to affected utility workers. Worker involvement and input is valued and used.

Enron and DOER object to a variety of MassElectric's proposed Terms, Conditions, and Settlement Process with Suppliers under Retail Delivery Rates. (Attachment 9).

. Response

Department approval of MassElectric's Terms, Conditions, and Settlement Process with Suppliers under Retail Delivery Rates is not a condition of the Agreement and the issues raised in the Enron and DOER comments may be deferred pending the issuance of the anticipated order in DPU 96-100 or the institution of some new generic investigation. The latter approach may be desirable given that the commenters have raised generic issues that will be common to all electric companies in the Commonwealth as they move to retail choice on January 1, 1998 and the resolution of many of these issues is also dependent upon future FERC actions.

2. Terms And Conditions For Distribution Service Customers

a. Comments

DOER filed comments suggesting changes to certain aspects of MassElectric's proposed Terms and Conditions with Customers under Retail Delivery Rates. (Attachment 4). *See* DOER, pp. 12 - 13.

. Response

The Attorney General submits that these issues should be treated the same as those addressed in the preceding response.

3. Terms And Conditions For MassElectric/AllEnergy Employees

a. Comments

A number of commenters suggested that the employee code of conduct set forth in Attachment 14 of the Agreement is too limited. *See e.g.,* Comments of CPC, p. 5, Att. A; Comments of Enron, pp. 15-16; Comments of DOER, pp. 29-33.

. Response

Department approval of MassElectric's proposed "Code of Conduct" is not a condition of the Agreement and the issues raised relative to that document may be deferred pending the issuance of the anticipated order in DPU 96-100 or the institution of some new generic investigation. The latter approach may be desirable given that the commenters have raised generic issues that will be common to all electric companies in the Commonwealth as they move to retail choice on January 1, 1998 and the resolution of many of these issues is dependent upon future FERC actions.

C. NEPOOL Reform

1. Comments

Some commenters expressed concern with the NEPOOL Restructuring Proposal contained in Attachment 11 to the Agreement. These comments expressed concern over the real independence of the ISO as well as the potential for the ISO to act as a competitor of marketers. *See* Comments of CPC, p. 8 and Att. B, pp. 1-2; Comments of XENERGY, pp. 6-7.

2. Response

By its own terms the Agreement does not even contemplate Department approval of MassElectric's position on NEPOOL reform. Rather, the inclusion of Attachment 11 is intended to hold NEES to a commitment to continue to support the proposal that was then pending. Many of the details of NEPOOL reform are outside of the Department jurisdiction and the Attorney General submits that the Department's views of the adequacy of the proposal set forth in Attachment 11 should not affect its decision on whether or not to approve the Agreement.

D. Transmission Service Unbundling, Rate Design and Cost Allocation

1. Comments

Some comments expressed concern that the Agreement did not provide for an unbundling of the transmission service provided by NEP to MassElectric distribution customers, that it

provided for a flat per kWh charge for those transmission services and it did not provide adequate incentives for NEP to operate its transmission system in an efficient manner. Comments of Federated Department Stores, p. 7; Comments of Western Mass. Industrial Group, p. 6; Comments of Local 464, *et al.*, p. 13; *see also* XENERGY Comments, pp. 5-9.

2. Response

At the outset, it is important to emphasize that the Agreement only addresses the billing by MassElectric for transmission billings it receives from NEP and other entities. Thus, the Agreement does not seek to resolve whether or not transmission on NEP facilities will be available for sale by NEP to marketers or end users. While the Attorney General believes that there is very little need to unbundle transmission in short-run, the Department should need not and, indeed, cannot resolve the unbundling issue here.

IV. CONCLUSION

WHEREFORE, for the all of the foregoing reasons, the Attorney General submits that the Department should approve the AG/NEES Agreement.

RESPECTFULLY SUBMITTED
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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding. Dated at Boston this 5th day of November, 1996.

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